DEPARTMENT OF STATE REVENUE

04-20200107R.SODR

Supplemental Final Order Denying Refund: 04-20200107R
Retail Sales Tax
For Tax Year 2017

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Supplemental Final Order Denying Refund.

HOLDING

Company is not entitled to additional refund because the applicable statute subtracts repossessed vehicles from the bad debt calculations.

ISSUE

I. Bad Debt Deduction - Gross Retail Tax.

Authority: IC § 6-2.5-6-9; *SAC Finance Inc. v. Indiana Dep't of Revenue*, 24 N.E.3d 541 (Ind. T.C. 2014); *Caylor-Nickel Clinic, P.C. v. Indiana Dep't of State Revenue*, 569 N.E.2d 765 (Ind. T.C. 1991); *Miles, Inc. v. Indiana Dept. of State Revenue*, 659 N.E.2d 1158 (Ind. Tax 1995).

Taxpayer argues that the Department erred when it disallowed a portion of Taxpayer's refund claim.

STATEMENT OF FACTS

Taxpayer is a finance company for a related "buy-here-pay-here" car dealership. Taxpayer's affiliate sells vehicles to customers on an installment basis and then sells the installment contract to Taxpayer. The installment contract includes the sales tax on the price of the vehicle. Taxpayer requested a refund of sales tax in which the installment contract was written off as bad debt. The Indiana Department of Revenue ("Department") conducted an investigation of Taxpayer's business records and reduced Taxpayer's refund request. Taxpayer disagreed with that decision and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. The Department issued a Final Order Denying Refund, 04-20190149R, denying Taxpayer's protest. Taxpayer timely filed a rehearing request, and an administrative rehearing was conducted. This Supplemental Final Order Denying Refund results.

I. Bad Debt Deduction - Gross Retail Tax.

DISCUSSION

Taxpayer requested a refund of sales tax included in defaulted vehicle installment contracts which were then included in bad debt deductions. The Department denied a portion of Taxpayer's refund because the value of repossessed vehicles was removed from the market discount, bad debt calculation. Taxpayer specifically protests the Department's removal of market discount value of repossessed vehicles and argues that it should be included in the bad debt calculation. Taxpayer claims it treated the repossessed vehicles as "partial payments" on the installment contract. These "partial payments" were included in the Taxpayer's calculation of bad debt. Taxpayer also amended its refund claims based on a prior decision from the Department that are addressed in this decision. Taxpayer argues that the Department's previous decision requires the Department to not only grant the refund but grant the amended refund claims resulting in a larger refund request.

This final determination addresses whether pursuant to IC § 6-2.5-6-9(d)(2)(E) the taxpayer's basis in the installment contract is fully reduced by the value of the repossessed vehicle.

IC § 6-2.5-6-9 states in part:

> (a) In determining the amount of state gross retail and use taxes which a retail merchant must remit under section 7 of this chapter, the retail merchant shall, subject to subsections (c) and (d), deduct from the retail

merchant's gross retail income from retail transactions made during a particular reporting period, an amount equal to the retail merchant's receivables which:

(1) resulted from retail transactions in which the retail merchant did not collect the state gross retail or use tax from the purchaser;

(2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) were written off as an uncollectible debt for federal tax purposes under Section 166 of the Internal Revenue Code during the particular reporting period.

(b) If a retail merchant deducts a receivable under subsection (a) and subsequently collects all or part of that receivable, then the retail merchant shall, subject to subsection (d)(6), include the amount collected as part of the retail merchant's gross retail income from retail transactions for the particular reporting period in which the retail merchant makes the collection.

. . . .

(d) The following provisions apply to a deduction for a receivable treated as uncollectible debt under subsection (a):

(1) The deduction does not include interest.

(2) The amount of the deduction shall be determined in the manner provided by Section 166 of the Internal Revenue Code for bad debts but shall be adjusted to exclude:

(A) financing charges or interest;

(B) sales or use taxes charged on the purchase price;

(C) uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid;

(D) expenses incurred in attempting to collect any debt; and

(E) repossessed property.

(3) The deduction shall be claimed on the return for the period during which the receivable is written off as uncollectible in the claimant's books and records and is eligible to be deducted for federal income tax purposes. For purposes of this subdivision, a claimant who is not required to file federal income tax returns may deduct an uncollectible receivable on a return filed for the period in which the receivable is written off as uncollectible in the claimant's books and records and would be eligible for a bad debt deduction for federal income tax purposes if the claimant were required to file a federal income tax return.

(***Emphasis added***).

Taxpayer cites to Department's previous Final Order Denying Refund, 04-201900149R. Taxpayer believes that in that Final Order Denying Refund, the Department stated that the value of repossessed vehicles should not be considered in the calculation of bad debt. Taxpayer argues that exclusion of the repossessed vehicles effectively increases the bad debt basis, resulting in a larger refund than originally requested. This argument implies that the value of repossessed vehicles should be treated as non-existent when calculating bad debt.

Taxpayer also argues that:

> Partial payments and related payments are treated in an economically consistent manner. That is, the portion which is considered an "accretion" of wealth is income, and that portions of which is treated as recovery of basis is not taxable. For example, a payment "with respect to stock" in the form of a dividend is taxable income to the shareholder, but does not impact the shareholder's basis in his stock. IRC § 61(a)(7); IRC § 301(c)(1).

Taxpayer initially explained it has been treating repossessed vehicles as partial payment on the installment contracts. Taxpayer's protest letter states, "First, there is a fundamental distinction between that portion of a receipt which represents (a) a repayment of principal - it is not taxable and reduces the holder's basis, and (b) ordinary income or capital gain - it is taxable income and does not reduce the basis. A payment is one or the other, not both. Second, the foregoing consequences apply regardless of whether the payment is in the form of money or property. Treas. Reg. § 1.1001.-1(a)." But if the Department excludes the value of repossessed vehicles then the Department needs to grant Taxpayer's refund claim and amended refund claim.

"The Department notes that it cannot agree with Taxpayer for multiple reasons." As the Indiana Tax Court explained in *Miles, Inc. v. Indiana Dept. of State Revenue*, 659 N.E.2d 1158, 1164 (Ind. Tax 1995), "The Court cannot presume the legislature intended to enact a nullity." Most importantly, Taxpayer's calculation directly contradicts IC § 6-2.5-6-9. Indiana's bad debt statute explicitly states that repossessed property should be excluded from the calculation of bad debt. If taxpayer's argument regarding the Internal Revenue Code treatment of a repossession were to be taken as correct, then the General Assembly clearly intended a different treatment

through its requirement that repossessions be excluded from the IRC 166 calculation. This does not mean to treat the value of repossessed vehicles as "nonexistent" as Taxpayer's protest would imply. Rather this means to abide by IRS Publication 537, *Installment Sales*, https://www.irs.gov/publications/p537, p. 12-13, in that the value of repossessed vehicles is fully subtracted from the bad debt calculation. Furthermore, the repossessed vehicle is often reincorporated into Taxpayer's inventory as a constant revolving door between a sale resulting in bad debt and inventory for the next sale.

Taxpayer states that it relies on the Indiana Tax Court's guidance when calculating its bad debt. Indiana's case law also supports the Department's interpretation and application of IC § 6-2.5-6-9. First, *SAC Finance Inc. v. Indiana Dep't of Revenue* ("*SAC II*"), interpreted IC § 6-2.5-6-9 to mean that:

> [A] retail merchant (or its assignee) [is required] to deduct the amount written off as uncollectable debt for federal tax purposes under IRC § 166 from its gross retail income. *See* I.C. § 6-2.5-6-9(a)(3). Accordingly, the amount written off under IRC § 166 is incorporated into the Indiana calculation solely as the computational starting point in determining Indiana's bad debt deduction.
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> Indiana Code § 6-2.5-6-9(d) lists the types of revenue that must be excluded from this starting point in calculating the amount of the Indiana bad debt deduction. I.C. § 6-2.5-6-9(d)(1)-(2). **Specifically, Subsection (d) requires a taxpayer to exclude amounts that reduce the original sales tax base (*i.e.*, the value of repossessed property or property still in the seller's possession)** and that were not part of the original retail sales tax base (*i.e.*, interest, financing charges, sales or use tax, and debt collection expenses) from the difference between gross retail income and the amount of federal bad debt.

24 N.E.3d 541, 546 (Ind. T.C. 2014). (Internal citation omitted) (**Emphasis added**).

SAC II, clearly states that the Taxpayer was required to exclude repossessed vehicles from the base calculation. *Id*. The statute provides that repossessed vehicles must be excluded from the bad debt calculation. In addition, the Indiana Legislature does not keep a record to elaborate on legislative intent and the courts have decided that the best evidence of legislative intent is the statue itself; if the Legislature intended to choose specific language the court may not expand or contract the meaning of the statute. *Caylor-Nickel Clinic, P.C. v. Indiana Dep't of State Revenue*, 569 N.E.2d 765, 769 (Ind. T.C. 1991). Contrary to Taxpayer's protest, *SAC Finance*, does not give explicit permission to allow market discount to the value or repossessed vehicles or treat repossessed vehicles as "nonexistent".

In *SAC II*, the Indiana Tax Court specifically stated that repossessed vehicles are excluded from Taxpayer's I.R.C. § 166 bad debt calculation, pursuant to IRS Publication 537. 24 N.E. 3d 541, 546. In addition, the Tax Court also stated that, "the portion of each **installment payment** [paid by customer] characterized as market discount income for federal income tax purposes is income that has **actually been paid to SAC** [and not taken by SAC]." *Id*. at 547. (**Emphasis added**).

The intent behind allowing a deduction for bad debt is to make the Taxpayer whole; Taxpayer was denied potential income due to circumstances outside its control; it did not receive said income. In instances of repossessed vehicles Taxpayer is made whole; it recaptures the value of the vehicle. The value of the repossessed vehicle must be subtracted from the bad debt calculation because Taxpayer has recouped that value through repossession. Treating the value of the repossessed vehicle as nonexistent, or allowing Taxpayer to include it, results in a double dipping of the bad debt allowance. Furthermore, the Department properly calculated Taxpayer's bad debt deduction pursuant to IC § 6-2.5-6-9. Taxpayer's protest is therefore denied.

FINDING

Taxpayer's protest is denied.

September 1, 2020

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